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PAKISTAN

FISCAL TRANSPARENCY

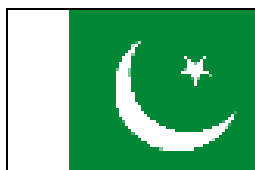
Country Report 2005

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PAKISTAN



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2005	2004	2003	2002
...				
Clarity of roles	--
Availability of information	--
Budget preparation	--
Accountability	--
Score	2.50	2.50	2.50	--

OUTLOOK & COMMENTARY

Pakistan continues to implement measures to improve fiscal transparency but, despite the government's commitment to reform, visible progress is slow.

The Fiscal Responsibility and Debt Limitation Ordinance was passed this year, targeting fiscal discipline, and the first stage of the Project for Improvement in Financial Reporting and Auditing was completed. However, there are still inadequate auditing and internal control procedures. The New Accounting Model and Chart of Accounts (NAM-CoA) was implemented at both a federal and national level this year, but data could be improved by increasing capacity, especially at the provincial level. A Medium-Term Budgeting Framework (MTBF) for 2005-08 was successfully piloted in the ministries of health and population welfare this year. Four more ministries will also present MTBF budgets for 2006-2007 and other ministries are expected to follow.

Areas still requiring improvement are fiscal data and accounting, especially at the provincial and district level. Areas of the budget still remain unreported such as quasi-fiscal activities and analysis of fiscal risks. However, despite problems, there are many plans and projects currently underway to develop fiscal transparency and the outlook is generally optimistic.

EXECUTIVE SUMMARY

2.50 Intent declared

Pakistan has continued its steady improvement in fiscal transparency this year, especially in the areas of fiscal discipline, budget forecasting, accounting systems and tax reform. The Fiscal Responsibility and Debt Limitation Ordinance was passed by Parliament in June 2005. It will increase transparency and fiscal discipline by requiring the federal government to eliminate its revenue deficit and reduce public debt to a prudent level through effective public debt management. However, some commentators have highlighted flaws in the law; for example, it does not stipulate any procedures for when targets are breached.

The federal government and all provinces have used a GFS-compatible New Accounting Model and Chart of Accounts (NAM-CoA) for this year's budget documents. These were piloted last year by the federal government and one of the four provinces. This year, all remaining provinces used the new system apart from Baluchistan, where both the old and new systems of accounting were used concurrently owing to problems with adopting the new model. The overall size of the budget documents prepared under the new system, are twice the size of the old system documents, reflecting the additional details in the new budgets. However, implementation of NAM-CoA has suffered because of a lack both of skilled officers and physical infrastructure. Data still lacks consistency and quality. More training of staff is needed in the new accounting module.

The first stage of the Project for Improvement in Financial Reporting and Auditing (PIFRA), begun in 1997, finished this year. Computerised accounting sites have been successfully set up online, which has helped to reduce corruption to some degree. Federal budget documents and those for the North West Frontier Province have been using a PIFRA model for the last two years. From this year, remaining provinces will be preparing documentation under the new model. However, implementation has been hampered by the lack of infrastructure and qualified staff at the district level. The quality of information received has been mixed. The second stage of PIFRA will focus on setting up district and sub-district sites.

In 2002, a project piloting a Medium-Term Budgeting Framework (MTBF) in the ministries of health and population welfare began. The budget under MTBF (2005-08) for these ministries was presented to the Parliament this year. Four more ministries will also join soon and present MTBF budgets for 2006-2007. Others ministries are expected to follow. Privatisation in utilities and banking has also continued and there are plans for more in the coming year. About 85% of Pakistan's banking and financial sector is now in private hands.

Areas still requiring improvement are fiscal data and accounting, especially at the provincial and district level. Partly due to remaining data problems, there has been no progress in meeting SDDS requirements this year. Quasi-fiscal activities are still not reported in the budget; neither is there any in-depth analysis of fiscal risks. There also continues to be a lack of internal controls and internal auditing, although steps to improve this are being taken.

Pakistan's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions, and responsibilities of government

The roles and responsibilities of the federal and provincial governments are stipulated in the 1973 Constitution of the Islamic Republic of Pakistan and the 1973 *Rules of Business*. Pakistan's constitution was temporarily suspended in October 1999, when the government of Prime Minister Nawaz Sharif was removed from power by the armed forces led by General Pervez Musharraf. A Provisional Constitution Order was then issued by the military government of President Musharraf. Since then, the constitution has been restored in phases, with full restoration taking effect in March 2003.

Under the constitution, there are three tiers of government: the federal government based in Islamabad, the regional level (which is comprised of the governments of four provinces, one territory, and one capital territory), and the municipal administrations. The constitution specifies the structure and functions of government, providing for executive, legislative, and judicial branches of government. The responsibilities of the federal and provincial governments are delineated in the constitution¹, as are rules governing the administrative relations between the federal government and the provinces.² Internationally accepted statistical definitions of general government activity are applied.³ The provinces enjoy legal, fiscal, and financial independence.

After taking power in 1999, the Musharraf government announced an ambitious devolution agenda aimed at reconstructing the institutions of the state through the establishment of a democratically elected system of local government. Though not set out in any single document, the objectives of Pakistan's devolution programme are contained in various publications from the National Reconstruction Bureau (NRB), Local Government Ordinances, and many of the 297 other ordinances promulgated over the three years of the military government.

Despite devolution, Pakistan remains, constitutionally, a two-tier federal state. However, as of 2004, there are 6,458 new local governments for the population of 146 million -- 97 districts and 4 city districts, 306 *tehsil* municipal administrations and 29 city towns, and 6,022 union administrations.⁴ Government responsibilities have been devolved in the new structure. District governments have been given functional responsibility for delivering elementary and secondary education, primary and secondary health services, and building intra-district roads, while towns and *tehsils* have been assigned municipal service responsibilities.

Coordination and management of budgetary activities

The 1973 constitution establishes the basic framework for the management of public finance, the division of powers, and the distribution of revenues between the federation and the provinces. The competencies of government agencies are defined in the 1973 *Rules of Business*. The precise allocation of responsibilities for budget management is described in the *New System of Financial Control and Budgeting* introduced in 2000, which is further

complemented by orders and instructions from the Ministry of Finance (MoF). The procedures for budget management at the provincial level replicate the central government system.⁵

Under the system established by the constitution, the proceeds of certain taxes, loans, and loan repayments are paid into a consolidated fund that is then divided among the federation and the provinces to supplement the income they receive from their own revenue sources.⁶ The rules for payments from the consolidated fund are also stipulated in the constitution.⁷ Some essential expenditure, including public debt service, is automatically drawn from the consolidated fund, while all other expenditures must be preceded by a formal 'demand for grants' and authorised by the legislature. The federal government meets any additional requirements of the provinces through various alternative mechanisms, including grants, subsidies, and emergency relief.

The constitution also provides (under Article 160) for the periodic establishment of a National Finance Commission (NFC), a body charged with making recommendations to the government on the operation of the consolidated fund, borrowing powers, grants-in-aid, and related issues. The NFC is also supposed to ensure that the share of tax revenue allocated to each province is commensurate to its needs, although in practice fiscal imbalances are common. The government is currently working on a new revenue-sharing arrangement between the federation and the provinces to reduce fiscal imbalances. Each province relies, in turn, on a Provincial Finance Commission (PFC) to allocate funds between provincial and district governments as stipulated by the 2001 Devolution Act. The National Reconstruction Bureau, which is accountable to the National Assembly, is responsible for advising the government on the devolution process.

While budgetary practices at the provincial level broadly replicate the federal standards, certain functions remain largely vested in the central administration. These include audit, accounting and taxation. The Auditor General is constitutionally independent from government and submits reports directly to the legislature. Provincial authorities can borrow funds only with the explicit consent of the federal government if they have any outstanding credit obligations to the central administration.⁸

The lack of transparency in the disbursement of some funds remains a concern. While the NFC and PFC formulas for calculating allocations are publicly available,⁹ the disbursement of discretionary grants -- which can be a significant percentage of regional and local government revenues -- is more opaque. Indeed, the percentage of the Provincial Consolidated Fund that is transferred according to the established formula is less than 8% in all provinces, so that most funding for local government is, in effect, negotiated.¹⁰ Negotiated revenues provide opportunities for opaque fiscal management and for the allocation of revenues based on non-merit-related criteria. To address this issue, the Asian Development Bank has recommended that discretionary grants be replaced with mandatory revenue-sharing transfers to make transfers more transparent.¹¹

The Fiscal Responsibility and Debt Limitation Ordinance was passed by Parliament in June 2005. It will increase transparency and fiscal discipline by requiring the federal government to eliminate its revenue deficit and reduce public debt to a prudent level through effective public debt management. In addition, the law requires the federal government to provide the National Assembly with three economic policy statements in each financial year. However, commentators have highlighted flaws in the law. For example, it does not stipulate any procedures for when targets are breached. Furthermore, there is suspicion that the government can easily fudge the figures (for example the revenue deficit figures) to ensure targets are met.¹²

The legal independence of the provinces has created some problems for budgetary coordination. For instance, the 2005 Fiscal Responsibility and Debt Limitation Ordinance does not currently apply to provincial governments and will have to be replicated in local legislation to bring about nationwide compliance. The government can exert influence on the provinces by imposing conditionality on loans issued to sub-national governments.

Relations between government and public sector agencies

Even though the State Bank of Pakistan (SBP) enjoys considerable formal independence, it is required to consult with the government to ensure policy coordination. The SBP is authorised to provide advances to the federal, provincial, and local governments, either through government securities or loans repayable within a three-month period.¹³ However, the actual interest rates, conditions, and maturities of advances by the SBP to federal, provincial, and local governments are not disclosed.¹⁴ Aggregate figures on SBP lending to the federal and provincial governments are available on the SBP website.¹⁵

The SBP uses special funds to provide credit through commercial and development banks to a variety of entities. Such loans are primarily channelled to agriculture, industry, exports, and loan guarantees. The credit funds derive their initial financing from SBP profits in accordance with a joint decision by the SBP and the government. All loans, with the exception of export credit, are issued at commercial rates. The activities of the funds are reported in the SBP Annual Report.

State-owned enterprises (SOEs) play a central role in the Pakistani economy and include the water and electricity utilities, gas distribution companies, refineries, railways, an airline, and some of the largest banks. The government also holds a major stake in the fertilizer industry. Many publicly owned companies are subject to administrative direction and regulation. Pakistan Railways (PR) and the Post Office function as government departments, and PR receives regular subsidies.

Since the early 1990s, Pakistan has been pursuing a strategy of restructuring its public sector entities through deregulation, privatisation, and transformation. SOEs are now increasingly run by managers pursuing commercial objectives.¹⁶ However, although the federal government has now privatised the Karachi Electric Supply Corporation (KESC), it still subsidises the Pakistan Water and Power Development Authority (WAPDA): both have been a large drain on the budget in terms of implicit contingent liabilities. Financial information, including cash flow statements and operational targets, is available on the MoF website for major SOEs -- including PR, WAPDA, and Pakistan International Airlines.¹⁷ WAPDA's balance sheet, available for the fiscal year 2002-03, but no later, is also posted on its website.¹⁸

Government involvement in the private sector

As observed above, the division between the public and the private sector in Pakistan has been blurred. However, the government is committed to increasing the private sector's role in the provision of goods and services. A programme of restructuring and privatising public enterprises was initiated in 1991 and the process has significantly accelerated in the past three years.¹⁹ The Privatisation Commission is entrusted with selling government assets and with offering concessions to operate them. The privatisation process constitutes an important element of fiscal consolidation, with 90% of revenues allocated to debt retirement and the remaining 10% going to poverty alleviation.²⁰ As part of the programme, a legal framework aimed at establishing a fair and transparent mechanism for privatisation has been put in place.

Major privatisations have moved forward in the past three years, albeit slowly. The process of unbundling WAPDA, although formally completed by December 2003, will not make the company fully autonomous in financial and managerial terms.²¹ WAPDA's 13 electricity distribution centres have been privatised, though power generation will remain in public hands in the medium term. The privatisation of KESC has been completed.²² In the financial services sector, all the major banks, apart from the National Bank of Pakistan (NBP), have been privatised. As of November 2005, about 85% of Pakistan's banking and financial sector is in private hands. The largest bank in the country, NBP, with a market share of approximately 20%, remains state-owned, and its privatisation prospects are

uncertain.²³ The government has also pursued an Oil and Gas Reform Programme since 2000 designed to restructure and privatise companies in the sector. The privatisation commission is in the process of short listing for sale eleven companies among which are the Kot Addu Power Company, the State Life Insurance Company, Pakistan Steel, Pakistan Petroleum Company and Pakistan State Oil. The privatisation of Pakistan Telecommunication Company Limited (PTCL) has been delayed.²⁴

At the same time, the government is in the process of deregulating the economy to create a more level playing field between public and private enterprises. Tariffs and other types of protection are being reduced. The import regime has been liberalised, and the custom duty, which used to be a major revenue-generator, has fallen significantly. The exercise duty has also been reduced. In previous years, the government was said to periodically interfere with the operations of regulatory agencies. However, commentators felt that this is no longer a major concern.

There should be a clear legal and administrative framework for fiscal management.

Legal framework for budgetary activities

Articles 80-88 of the Pakistani constitution lay down the budget procedures for which the MoF bears ultimate responsibility. The 1973 constitution outlines the expenditure responsibilities of the federal government (Federal Legislative List) and the areas of shared responsibilities (Concurrent Legislative List). All residual functions are the domain of provincial governments. Local government functions are defined under provincial laws through the Local Government Ordinances (LGOs).

Preparation of the budget is based on well-defined timetables. Circulars issued by the Finance and Planning Ministries initiate the process eight to ten months before submission of the budget. Agencies are requested to submit a statement of permanent expenditures on the current budget, projected expenditures on existing development projects, proposals for new expenditures, and proposals for expenditures on new development projects. By December to January each year, line departments submit budget proposals after review by the MoF Financial Advisors. Negotiations between the MoF, the Planning Division, and the respective ministries generally continue until March or April.

The federal government is required to present an annual budget statement to the National Assembly. If necessary, the legislature may approve a Supplementary Budget Statement or an Excess Budget Statement.²⁵ The existing budget procedures are described in a 1998 Finance Division manual entitled 'Revised System of Financial Control and Budgeting'.²⁶ Information about key legislation and ordinance affecting budgetary activities, including the 2005 Fiscal Responsibility and Debt Limitation Ordinance, is available on the MoF website.

Legal framework for taxation

Historically, Pakistan has had a complex tax framework, but all taxes do have an explicit basis in law. The 1973 constitution assigns almost all taxes with any significant revenue potential to the federal government. The exceptions are the Agriculture Income Tax (AIT), Urban Immovable Property Tax (UIPT), Motor Vehicle Tax (MVT) and Stamp Duties. On the other hand, local government tax bases are assigned through Local Government Ordinances and not through the constitution, and therefore tax assignments between the provinces and local government can be changed according to changing requirements. The Federal Government body responsible for tax administration in Pakistan is the Central Board of Revenue Board, which is a division of the MoF.²⁷

Making tax administration more transparent and efficient is one of Pakistan's more serious challenges. Widespread collusion between taxpayers and tax officials has been facilitated by the discretionary powers of tax officials, complex tax rules, and weak supervision of staff.²⁸ In July 2002, major changes were introduced through a new

system based on Universal Self Assessment and risk-based audit and record keeping, which minimises taxpayer interaction with tax officials. Also, the number of income tax exemptions has been reduced -- 20 exemption categories were abolished in fiscal year 2003-04 alone. The government has eliminated all so-called 'tax whitener' schemes, which used to be a common instrument of tax evasion.²⁹ At the same time, tax rates are being cut to stimulate economic activity and to encourage compliance, which remains low.³⁰

The reforms of the Central Board of Revenue (CBR) launched in 2002 appear to be progressing adequately.³¹ The CBR is improving the quality of its human resources and has adopted a recruitment policy of merit-based remuneration. A tax ombudsman's office has been established to deal with dispute resolution. As pilot projects for improved tax collection, the government has set up Large Taxpayers Units (LTUs) and Medium Taxpayers Units (MTUs). These units will form the basis of a new, IT-based compliance management system. Already, performance indicators, including revenue targets and changes in tax policies, are published on a quarterly basis and are also available on the CBR website.³² Following the success of the LTU in Karachi, a second LTU was established in Lahore in August 2004. In addition, two MTUs are being made operational. A pilot customs house in Karachi also opened in 2004, featuring electronic filing of declarations by importers on a self-assessment basis and parameter and risk-based auditing.³³

Ethical standards for public servants

The 'Government Servants (Conduct) Rules' of 1964 is the main legal document governing the behaviour of public servants in Pakistan. The rules address conflict-of-interest issues, require that public servants declare their assets each year, and prohibit them from conducting business or entering into agreements that may conflict with their official duties. The government has amended the 1973 Civil Servants Act to specify the rules governing the dismissal of civil servants.³⁴

Low pay and a lack of effective supervision have entrenched corruption, especially at the sub-national level. To address this problem, the government launched a National Anti-Corruption Strategy (NACS) in 2003. The strategy, which aims to reduce tolerance for corruption, prevent corruption through improved management and governance, and improve accountability mechanisms, has moved forward to some extent since its inception, although critics say that it is only rhetoric and that there has to be a change in political will for noticeable progress to be made.³⁵ The National Accountability Bureau (NAB) is working with provincial anti-corruption agencies to enforce and prevent corruption in the civil service. Vigilance units have been set up in several government departments, and a broad awareness campaign was launched in the media in January 2004. Efforts are also underway to contain the 'Benami' -- the practice whereby assets are held in the name of a person who is not the true beneficiary -- following a report to the cabinet in October 2003 on this issue. Identity cards are now being introduced to contain this problem.³⁶ However, Transparency International's Corruption Perceptions Index shows a worsening in corruption: scores were 2.5, 2.1 and 2.1 (out of 'least corrupt' score of ten) for 2003, 2004 and 2005, respectively and this year Pakistan was among the worst 15 countries.³⁷

2. PUBLIC AVAILABILITY OF INFORMATION



Intent declared

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Central government operations

Article 171 of the 1973 constitution stipulates that ‘the reports of the Auditor General relating to the accounts of the Federation shall be submitted to the President, who shall cause them to be laid before the National Assembly. The reports of the Auditor General relating to the accounts of a Province shall be submitted to the Governor of the Province, who shall cause them to be laid before the Provincial Assembly.’³⁸

Currently, the MoF makes available through its website quarterly summaries of Pakistan’s fiscal operations, the budget speech of the finance minister, a *Budget at a Glance* document summarising the fiscal position of the central government, a copy of the Finance Bill that gives effect to the proposed budget, and the *Economic Survey*. The survey includes economic information by sector, and information about contingent liabilities, tax expenditures, and external debt and liabilities, among other categories, and is published shortly before the budget.³⁹

The 2005 Fiscal Responsibility and Debt Limitation Ordinance requires the federal government to provide the National Assembly with three economic policy statements in each financial year. According to the legislation, these Economic Policy Statements must ‘incorporate to the fullest extent possible all government decisions which have a material effect on the economic situation of the country, except those that have been excluded for specified reasons by the finance minister.’⁴⁰ The statements to be presented by the government once the ordinance is passed will include the following: a Medium-term Budgetary Statement included in the Annual Budget Statement (ABS); an Annual Fiscal Policy Statement included in the ABS; an Annual Debt Policy Statement included in the ABS; a Mid-year Economic Report by the end of February; and an Annual State of the Economy Report by the end of June. The mid-year report is expected to be released on time and the debt policy statement is currently being drawn up with the assistance of the World Bank.

The timeliness of financial statements has improved, with annual accounts for the federal government being produced within six months of year-end. Quarterly fiscal reports are also published on the MoF’s website with a two month lag. Although monthly federal fiscal reports are also prepared, these are not published due to the long time lag involved.⁴¹ Data reliability has also improved. Reconciliation of expenditures reached 99% at the federal level and 70-91% at the provincial levels in 2003.⁴²

In the medium term, the government is implementing a new, countrywide, public sector chart of accounts and financial reporting requirements under a computerised accounting system. This has been carried out through the World Bank-supported Project for Improvement in Financial Reporting and Auditing (PIFRA) begun in 1997. The first stage of PIFRA has finished and 40 computerised accounting sites have been successfully set up online, 18 more than were originally intended, and computerisation has helped to reduce corruption to some degree. Federal budget documents and those for the North West Frontier Province have been using a PIFRA model for the last two years. From this year, the remaining three provinces will be preparing documentation under the new model. However, implementation has been hampered by the lack of infrastructure (buildings, electricity etc.) and qualified staff at the district level, especially in the province of Baluchistan where, according to one commentator, there are

few trained district accountants. The quality of information received has been mixed. The second stage of PIFRA is due to start before the end of the year and will focus on setting up 132 district and sub-district sites. It aims to network the NWFP by the end of 2006, Punjab in 2007 and remaining provinces within the next three years. A further part of the project is focused on capacity building in the Offices of the Auditor General and Controller General of Accounts. However, commentators say there are problems in the progress to the second stage, as figures do not reconcile.⁴³ The training of PIFRA staff has been problematic, especially at the district level where only one third of trained officials have been put in place.⁴⁴

Pakistan joined the IMF's General Data Dissemination System (GDDS) in November 2003 and data on its statistical production and dissemination practices is consequently available on the IMF website.⁴⁵ Under its GDDS membership, the MoF has made several commitments to improve data quality and dissemination standards. Pakistan's practices are consistent with most GDDS recommendations, with the exception of data on GDP and wages and earnings. No progress has been made this year on developing an advance release calendar for the MoF website or in compiling and disseminating monthly data within one month.⁴⁶ However, GTZ, the German-based NGO, is funding a project to assist the Federal Bureau of Statistics in preparing quarterly accounts and GDP data, and the IMF is assisting with a methodology for wages and unemployment data. Pakistan has such a large informal sector though, that it will be difficult at present to publish complete and accurate data for these areas. The MoF is further developing a methodology statement for government operations data. In the medium term, the government is undertaking to implement a revised chart of accounts, as well as a new accounting model, which would be compatible with the eventual implementation of accrual accounting. The government adopted the IMF Government Finance Statistics Manual this year.⁴⁷

The government has indicated its desire to subscribe to the IMF Special Data Dissemination Standard (SDDS), and recently asked the IMF to undertake an assessment of its practices against the SDDS. In that review, the IMF concluded that before Pakistan can subscribe to SDDS, it would require more resources for data collection and dissemination, as well as more staff training and formal coordination among statistical agencies.⁴⁸ There has been little progress in meeting the standards required for SDDS this year; some critics have judged that there has been uncertainty regarding the government's commitment to publish timely and accurate data.⁴⁹

The methodologies for price indices and balance of payments statistics broadly follow international standards. However, in 2004 the IMF pointed to significant shortcomings in the methodological soundness of other macroeconomic statistics, especially those regarding the scope of the national accounts and the classification and sectorisation systems for government finance and monetary statistics.⁵⁰ No progress has been made in the last year in this area and commentators agree that reform is required in the national accounts.⁵¹

Transparency appears to be improving in other respects. While there may have been a prior tendency by the government to overestimate revenues, there is agreement from a number of different sources that this practice no longer continues.⁵² Also, the MoF reports, in its *Economic Survey*, actual cash flows to cover explicit and implicit contingent liabilities since 2001 and explains their fiscal significance.⁵³ Information on tax expenditures is also covered in the same report.

Public sector operations

The federal budget details central government grants to provinces, but comprehensive reports on provincial receipts and spending are presented only to the provincial assemblies. Federal level reporting will have to wait until the introduction of a National Financial Commission for which there is no date fixed as yet.⁵⁴ The MoF's *Economic Survey* provides an overview of the consolidated federal and provincial budgets since 2001-02.⁵⁵ The SBP includes data on the combined federal and provincial budgets in its *Annual Report* based on a combination of budget documents and SBP data.

The Controller General of Accounts (CGA) prepares *Combined Finance and Revenue Accounts for the Federal and Provincial Governments of Pakistan* from audited accounts of each level of government. However, the materials have tended to be compiled with a considerable delay and are deemed in some instances to be inaccurate, although the situation is expected to improve with the implementation of the second stage of PIFRA. Every province had a director general appointed for district and provincial audits in 2003-04. There have been systematic efforts in recent years to improve the quality of data reconciliation and the timeliness of data dissemination. At the federal level, virtually full reconciliation has been achieved between departmental spending and receipts records and the Accountant General of Pakistan Revenue (AGPR) accounts. Timeliness of reporting has improved with reconciliation data available three weeks after the end of each calendar month. Progress has been more mixed at the provincial level.⁵⁶

There has also been no progress in reporting quasi-fiscal activities, something that was highlighted by the IMF in 2000 and again in 2004. The *Economic Survey* only discloses explicit and implicit contingent liabilities, but not quasi-fiscal activities or the activities of public enterprises and institutions in detail.⁵⁷

A commitment should be made to the timely publication of fiscal information

Debt reporting

The quality of information on public debt has improved dramatically in recent years. The MoF's *Economic Survey* now provides a comprehensive overview of debt servicing costs and a breakdown of domestic debt broken down into permanent, floating, and unfunded debt. The *Survey* also includes data on foreign exchange liabilities, and debt servicing, although debt statistics for the current and previous year are only provisional. Broad trends of overall public debt, accompanied by recent developments, are also discussed.⁵⁸ For the past three years, the government has also been producing detailed information on debt on both a monthly and a quarterly basis, in the *External Debt and Liabilities Quarterly Report*, although this information is not publicly disclosed. Data is also found in the annual *Economic Survey*.⁵⁹ The State Bank of Pakistan also compiles data on public debt. Quarterly data is provided on the external debt and liabilities, on service costs, and on the stock of outstanding domestic debt.⁶⁰

The 2005 Fiscal Responsibility and Debt Limitation Law makes provisions for debt reporting in its Annual Debt Policy Statement. Targets have been set to reduce the revenue deficit to zero by 2007-08 and the government is already ahead of targets.⁶¹

Advance release calendars

While the MoF is committed to regular provision of government fiscal data and the statistics on its website are updated accordingly, there has been no progress in releasing formal advance release calendars for the past two years. However, the Federal Bureau of Statistics publishes such a calendar for price and trade data.⁶²

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING



Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

Fiscal policy objectives are clearly identified in the budget documents and are highlighted in the budget speech of the minister of finance. In addition, budgets are now placed in a three-year macroeconomic framework with targets set for all key variables. Broader fiscal policy objectives with a specific focus on poverty reduction are spelled out in the government's 2003 Poverty Reduction Strategy Paper (PRSP).⁶³ Medium-term fiscal objectives will also be outlined in the Medium-Term Budgetary Statement and Annual Fiscal Policy Statement.

Macroeconomic framework

The MoF produces an *Economic Survey* covering the current macroeconomic situation in the country, as well as future prospects. The survey is always included in the budget documents submitted to the national assembly in connection with a new finance bill. However, the MoF does not publish its macroeconomic model, nor is there a formal mechanism for consultations involving independent experts.⁶⁴

In 2002 a project piloting a Medium-Term Budgeting Framework (MTBF) spanning three years in the ministries of health and population welfare began.⁶⁵ The budget under MTBF (2005-08) for these ministries was presented to the parliament in the *'Budget in Brief'* document, together with the Federal Budget for the financial year 2005-06 which was announced in June 2005. The Ministries of Finance, Education, Women's Division and Food and Agriculture will also join soon and present MTBF budgets for 2006-08. Others ministries are expected to follow.⁶⁶ The use of computerised financial management to assist ministries in budget operations is also part of the MTBF project, but will not be implemented until the second stage of PIFRA is well underway.⁶⁷

In addition, budgetary planning has been carried out within the framework of the Poverty Reduction and Growth Facility (PRGF) 2002-2004 agreed with the IMF in 2001.⁶⁸ This project came to a close in December 2004 and the government chose not to withdraw the final two tranches (amounting to 270 million US dollars) available under the PRGF. Instead, the government is operating its own endogenous programme called the Poverty Reduction Strategy. Reports on the new programme are made on a quarterly and annual basis.⁶⁹

Fiscal risks

The MoF does not at present publish any systematic analyses of sensitivity of its budget estimates to changes in economic conditions. Some discussion of macroeconomic factors bearing on the budget estimates is provided in the *Economic Survey*, but these do not amount to a formal assessment of fiscal risks.

However, transparency in this area is improving in some respects. As noted above, the reporting of contingent liabilities and tax expenditures has improved in the past two years and are now presented in the *Economic Survey*. However, they are not yet formally discussed or incorporated in the budget, although there are plans to include a table on these items in the next budget.⁷⁰ In addition, the 2005 Fiscal Responsibility and Debt Limitation Ordinance proposes specific limits on contractually binding guarantees (explicit liabilities) including those in rupee lending,

bonds, rates of return, output purchase agreements and other claims that may threaten the future fiscal stance of the government.

A significant source of fiscal risks stems from a substantial build-up of nonperforming loans (NPLs) due to lax lending practices by public commercial banks and development financial institutions. The Corporate and Industrial Restructuring Corporation was established in 2000 as an autonomous MoF unit with the main task of recovering overdue loans on behalf of state-owned banks and development financial institutions.⁷¹ While the aggregate NPL ratio for the banking system has been on a downward trend, it is still high and concentrated in the largest banks.⁷² The State Bank of Pakistan does publish detailed information on the extent of NPLs though. Also, the losses of public sector enterprises, led by two government-owned power utilities, have not been properly tackled and remain a potential threat to fiscal consolidation. The adoption of a formal fiscal rule as part of the draft Fiscal Responsibility and Debt Limitation Ordinance should reduce the fiscal risks posed by political pressures on the budget. Commentators noted that at the moment the government is in a comfortable fiscal position.⁷³

Fiscal sustainability

The budget documents put little emphasis on the sustainability of the budget deficit, but the issue is recognised as the central challenge for the government. The *Economic Survey*, particularly the section on 'Fiscal Development', discusses the sustainability of the debt position and shows both overall and primary budget deficits. Under the 2005 Fiscal Responsibility and Debt Limitation Ordinance, the government will be required to report regularly on fiscal developments and to set targets for debt reduction.

Budget presentation

Data reporting

Federal budget data is produced in a timely manner, supplied within 15 days of the end of the reference period. Data for provincial and district governments are also sufficiently timely, despite problems related to the lack of full computer automation in sub-national government administrations. Complete, audited final accounts of the government are available approximately seven months after the end of the reference year.⁷⁴

The first set of federal budget execution reports under the New Accounting Model and Chart of Accounts (NAM-CoA) were published in July 2004, although not publicly available. The overall size of the budget documents prepared under the new system, are twice the size of the old system documents, reflecting the additional details in the new budgets. Monthly publications have also been released in a timely manner over the past year. The IMF has stated that these reports are better organised, and there are now summary economic classification statements published.⁷⁵

Budget execution and monitoring

After legislative approval, the Finance Division of the government formally communicates the budget to the line ministries. The Finance Division keeps an appropriation ledger, which records initial budget distributions and subsequent adjustments.⁷⁶

The principal accounting officer (PAO) of each government entity is responsible for controlling spending. Drawing and disbursing officers have the duty to ensure that payment claims are approved in accordance with the Schedule of Authorised Expenditure. No request exceeding the available funds can be approved without a formal legal contract. In such an event, the PAO has the responsibility for locating the necessary funds. The procedures at the federal and provincial levels are identical.⁷⁷

However, mechanisms for internal control remain weak in some areas. The reports of the Auditor General show numerous instances across government of non-compliance of expenditure approvals with budget limits, delegation between authorities, and requirements for proper documentation of expenditures; misclassification of expenditures; and instances of fraud and misuse of public funds and assets.⁷⁸ However, a number of improvements have been made over the past year; newly appointed financial advisors are being placed in each of the line ministries who will follow an internal audit manual produced by PIFRA which should help to improve the consistency of the audits.⁷⁹

The government plans to improve transparency and legislative oversight through the Public Accounts Committees (PACs) of the National and Provincial Assemblies that review the findings of audit reports. The ad hoc PACs formed during the military government will be replaced with PACs under the auspices of the newly elected National and Provincial Assemblies. However, the federal government has yet to form its PAC, so that the backlog of un-reviewed reports remains substantial. Provincial PACs exist, but differ in terms of performance. Until all PACs are fully operational, all audit reports are to be examined by the Auditor General's office. There is also a huge backlog in terms of completed reports; PACs are only now completing reports for 2001-02. Commentators have stated that the PACs also suffer from a lack of credibility because of several shortcomings in technical capabilities; as such, it is hard to corroborate the quality and reliability of information.⁸⁰

Accounting basis

All accounting of fiscal flows currently takes place on a cash basis with the procedures explained in government accounting manuals. The government is currently working on initial preparations for the eventual introduction of accrual accounting. The use of accrual accounting is likely to begin very gradually.

Data classification broadly conforms to Government Finance Statistics (GFS) fiscal reporting requirements. Indeed, both the federal government and all provinces have been using a GFS-compatible New Accounting Model and Chart of Accounts (NAM-CoA) for this year's budget documents. These were piloted last year by the federal government and the North West Frontier Province. This year, all remaining provinces used the new system apart from Baluchistan where both the old and new systems of accounting are being used concurrently as in this province there are still problems with the new system. The overall size of the budget documents prepared under the new system, are twice the size of the old system documents, reflecting the additional details in the new budgets. Implementation of NAM-CoA has suffered due to a lack of skilled officers to implement it, as well as a lack of physical infrastructure and data still lacks consistency and quality. More training of staff is needed in the new accounting module.⁸¹

Procurement and employment

Federal employees in the Superior Services (grade 17 and above) are appointed through a competitive examination administered by the Federal Public Service Commission.⁸² The government has set up a Public Procurement Regulatory Authority, which will develop a procurement law and oversee its implementation.

Reducing corruption in the civil service, particularly at the provincial and local level, is a major challenge for Pakistan, and it affects procurement practices. The National Accountability Bureau (NAB), with a mandate to investigate alleged corruption, is complemented by individual Regional Accountability Bureaus in each of the country's four provincial capitals, and one in the federal area. If effective, these bodies will help reduce corruption in the procurement of government contracts. However, commentators stated that the NAB's effectiveness is decreasing with time, and further measures to increase transparency, civil rights and political participation needed to be implemented for accountability measures to be successful.⁸³

Progress to address the other shortcomings of Pakistan's procurement process has been slow. In May 2002, the president adopted an ordinance creating the Public Procurement Regulatory Authority (PPRA), but this has yet to promulgate national procurement rules applicable to all federal procurement. The pace of reform at the federal level has not accelerated as expected, although there has been preparation of new draft procurement rules by the PPRA that are compatible with international best practice.⁸⁴

Fiscal reporting

Pakistan has an overall framework of accounting and financial reporting overseen by the Accountant General of Pakistan for federal accounts and Accountants General for the provincial accounts. All these functions report to the Controller General of Accounts at the federal level.

The federal government fiscal data currently comprises the budgetary operations of the federal government and the public sector development programme. It excludes the *Zakat* extra-budgetary fund, social security funds, and locally financed operations of provincial and municipal governments. Data on interest payments is given separately and broken down into domestic and foreign. The system of classification broadly conforms to the IMF Manual on Government Finance Statistics. The data is provided on a quarterly basis with a delay of two months.⁸⁵

Under the 2005 Fiscal Responsibility and Debt Limitation Ordinance, the government is required to present the National Assembly with a *Medium-Term Budget Statement* with a three-year rolling Fiscal Framework, as discussed above. The *Annual Fiscal Policy* statement is required to specify how the budget targets relate to the debt reduction strategy. An Annual Debt Policy Statement will explain borrowing strategies and potential risks. An annual *State of the Economy* report will assess the performance of the economy against the targets set by the government.

Although data reconciliation has improved at the federal level, budget reporting at the provincial and districts levels remains an area of concern. Commentators stated that the state of budgeting and accounting in local governments is poor and there is little compliance to the 2003 Budget Rules.⁸⁶ There is a wide degree of variation between districts in particular, and it can take up to one to two years to provide sufficient data to make benchmark comparisons between districts.⁸⁷ The IMF has stated that far more training and resources are required if provinces and districts are to be able to execute their budget and provide data on expenditures and revenues in a timely and accurate way.⁸⁸ The problem also stems from a legal aspect since there are no formal legal requirements for reporting from the sub-district and district level to the provincial level. Equally, at the provincial level, there is no specific body allocated for the reporting of budgets. Commentators believed provincial financial commissions should be established -- something that was intended two years ago -- but no progress has been made.⁸⁹

Improving fiscal reporting at the sub-national level is also particularly urgent in light of Pakistan's ambitious devolution programme. To date, devolution of funding to district levels has not yet been completed in the North West Frontier Province or Sindh.⁹⁰

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

Data quality standards

The government has significantly improved the quality of fiscal data in recent years. A federal Fiscal Monitoring Committee tracks fiscal flows and manages efforts to improve data quality. Similar committees are being created at the provincial level. The Accountant General Pakistan is fully involved with the MoF in the preparation of fiscal reports, which are published on a quarterly basis, accompanied by commentary on data quality.

A recent assessment by the IMF found that institutions collecting and disseminating data on national accounts generally exhibited an adequate awareness of data quality. However, there are multiple factors that negatively affect the quality of the data, including obsolete computing resources, weak efforts to encourage reporting, and outdated benchmarks.⁹¹ The Ministry of Finance is aware of these limitations in capacity and intends to invest in more training to improve the reporting of the national accounts.⁹²

Independent scrutiny of fiscal information

Independent Audit

The office of the Auditor General enjoys constitutional authority and reports directly to the president. In the past, the Auditor General was responsible for both auditing and accounting functions, but now the government has separated the two functions.

The PIFRA project is supporting institutional reform and policy initiatives designed to improve auditing and accounting standards. A central objective of the programme is to develop the Auditor General's office into an independent supreme audit institution. Methodological reforms are designed to reduce traditional compliance audits in favour of more performance-type assessments.⁹³

The timeliness of audits has improved markedly in recent years, with audit reports starting to become available within one year of the end of the fiscal year.⁹⁴ An Annual Audit Programme that sets out specific goals and targets has been published, and the Auditor General has started the process of recruiting 800 qualified auditors to enhance its capacity to audit local governments. The post-decentralisation accounts for districts have now begun to be audited by the Auditor General.⁹⁵

However, a great deal remains to be done to improve internal auditing procedures at government agencies. Compliance with existing internal controls and procedures has been found to be inadequate in many cases.⁹⁶ Government ministries generally do not have an internal audit function. Audit functions are therefore largely left to the Auditor General of Pakistan (AGP), the external auditor. Also, there are no formal procedures to ensure effective risk management at the departmental level. While the appointment of new financial officers for auditing and the new PIFRA manual on internal auditing will be a good start to improving the situation, this is likely to take some time. The review that resulted in the separation of auditing from accounting functions also involved the preparation of a draft Ordinance for Internal Control, but this ordinance has been delayed.⁹⁷

National Statistics Agency

The Federal Bureau of Statistics (FBS) is a department of the Statistics Division. The Statistical Act of 1974 authorises the bureau to collect information for statistical purposes. The FBS has been given legislative assurances of independence. The FBS compiles statistics from many sources and produces a range of publications, including the *Statistical Yearbook* and the *Pakistan Statistics Handbook*. Among other functions, it keeps an administrative record of public finance statistics compiled by the fiscal authorities.⁹⁸ In connection with Pakistan's GDPS membership, the FBS is working on a systematic overhaul of its data collection and dissemination practices.⁹⁹

The FBS has been recognised for its professionalism. FBS staff are appointed on a permanent basis after meeting civil service entry requirements, and the head of the FBS, who may only be appointed from the ranks of the staff, may remain in the post until retirement. However, the IMF has recently observed that the FBS, its operations, and its credibility would benefit if it enjoyed greater autonomy from the government.¹⁰⁰

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Pakistan between 7 and 10 November 2005.

Ministry of Finance

10 November 2005

Dr Ashfaque Hassan Khan
Muhammad Yunis Khan

Economic Advisor
Auditor General

Ministry of Finance
Ministry of Finance

State Bank of Pakistan

10 November 2005

Mr Riaz Riazuddin

Economic Advisor

SBP Economic Policy Dept

ADDITIONAL INTERVIEWS

7 November 2005

Dr Ali Cheema

Associate Professor

Lahore University of
Management Sciences

8 November 2005

Henri Lorie

Senior Resident Representative

IMF

Riaz Hassan Naqui

Former Chairman

Central Board of Revenue

9 November 2005

Ismaila Ceesay

Senior Financial Management
Specialist

World Bank

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